PRE-DISPUTE ARBITRATION AGREEMENTS

Introduction

PROF. KATSORIS: Our first panel deals with pre-dispute arbitration agreements. The industry generally is not required to have an arbitration agreement in order to be brought to the forum, because, by belonging to the SROs, the industry has to submit to arbitration.[16] That's not true with the public. The pre-dispute arbitration agreement is what forces the public into the arbitration forum.

Many problems have arisen in connection with these pre-dispute arbitration agreements. Today we've assembled two gentlemen who started a lot of these headaches when they opposed each other in *Shearson v. McMahon.*[17] The first speaker on this subject will be Ted Krebsbach.

Panelists

MR. KREBSBACH: Thank you, Professor Katsoris and Chairman Donaldson. Just as there has been a lot of change in the whole area of securities arbitration over the past ten to twenty years, as Professor Katsoris has pointed out, there have been many changes with respect to pre-dispute arbitration clauses. In fact, if you look historically over the years, I would say that most of the major issues that arise or have arisen with respect to securities arbitration have been connected directly to the pre-dispute arbitration clause.

Things used to be a lot simpler than they are today. If you go back ten years, the law of the land was pretty clear. The Supreme Court stated in *Wilko v. Swan*[18] in 1953 that pre-dispute arbitration agreements could not be enforced with respect to disputes under the '33 Act,[19] and there was pretty much of a consensus that this rationale also applied to the Exchange Act of 1934.[20] In fact, back in those days, pre-dispute arbitration agreements were simple. They said that the parties agreed to submit all of their disputes to arbitration, and many also said that New York law would apply to any disputes. That pretty much was the state of pre-dispute arbitration clauses until the mid-1980s.

The first problem that came up with respect to pre-dispute arbitration clauses was SEC rule 15c2-2,[21] passed in the mid-eighties, where

16. NYSE Rules, *supra* note 14, Rule 600(a), ¶ 2600.

17. Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987). Theodore A. Krebsbach represented the petitioner and Theodore Grant Eppenstein represented the respondents. *Id.* at 222.

18. 346 U.S. 427 (1953).

19. *Id.* at 438; *see* Securities Act of 1933, 15 U.S.C. § 77(a) (1988).

20. Securities Act of 1934, 15 U.S.C. § 78(a) (1988).

21. 17 C.F.R. § 240.15c2-2 (1983), *repealed by* Exchange Act Release No. 25034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987).

the SEC required firms to put specific language in their agreements that said that investors do not have to arbitrate disputes under federal securities laws.[22] That was perhaps the first time that the language of the pre-dispute arbitration agreements received a lot of attention. The firms were opposed to this for a number of reasons: (1) they didn't like to have anyone dictate to them what they could put in a private contract, and (2) firms felt that the *Wilko* case was limited to the 1933 Act and should not apply to all of the federal securities laws.

In fact, in the *McMahon*[23] case in 1987 and the *Rodriguez*[24] case in 1989, the Supreme Court overturned its rationale in *Wilko* and said there was no reason that federal securities law claims cannot be arbitrated across the board.[25] As everyone recalls, the SEC played a major role in both of those cases, but primarily in the *McMahon* case where they filed an amicus brief on behalf of the brokerage firms.

The SEC subsequently revoked rule 15c2-2,[26] but there continued to be litigation with respect to the pre-dispute arbitration clause because many agreements with the old 15c2-2 language still existed. As you might expect, the courts went both ways on the issue of whether those old agreements prohibited arbitration of federal securities law claims. Some courts said these agreements evidenced intent of the parties not to arbitrate the disputes, but other courts disagreed. Eventually, because of *McMahon* and because the firms changed the language in their agreements, this issue died and is no longer with us.

The next big controversy had to do with what was called the AMEX window.[27] As Mr. Eppenstein is well aware, having argued the Court of Appeals case[28] successfully on this issue, the problem was that the agreements said firms agree to arbitrate pursuant to the rules of the various stock exchanges—including the American Stock Exchange—and there was a particular rule at the American Stock Exchange ("AMEX") that said members of the AMEX agree to arbitrate at the American Arbitration Association at the election of the customer. There was a lot of litigation between the firms and their customers about whether firms, because of that rule, had to arbitrate all of their disputes at the AAA.

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22. *Id.*

23. Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987).

24. Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989).

25. *McMahon*, 482 U.S. at 238; *Rodriguez*, 490 U.S. at 485.

26. 17 C.F.R. § 240.15c2-2 (1983), *repealed by* Exchange Act Release No. 25034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987).

27. American Stock Exchange Const. art. VIII, § 2(c) (1992) (providing that if any of the parties to a controversy is a customer, the customer may elect to arbitrate before the American Arbitration Association in the City of New York, unless the customer has expressly agreed in writing to submit only to the arbitration procedure of the American Stock Exchange).

28. Cowen & Co. v. Anderson, 558 N.E.2d 27 (N.Y. 1990).

Again, and you'll see this pattern historically, these issues were debated extensively at forums such as this, but ultimately resolved by the courts. Many firms again amended the language in their agreements to say that not only do I agree to arbitrate pursuant to the rules of these Exchanges, but I agree to arbitrate at that particular Exchange.

That, combined with the fact that there were a lot of rule changes after *McMahon*—both at the AAA and at the self-regulatory organization forums—narrowed the differences between the forums and caused that issue to lessen in importance, just like the SEC rule 15c2-2. It's not a major issue anymore.

I think that the lesson we learned is that public debate, the resource of going to the courts, and getting decisions back and forth, combined with changing the language of the agreements to meet the needs of both sides eventually solved the problem.

One of the issues that is present throughout all of this debate is the issue of the contract of adhesion.[29] It's worth noting briefly, not because I think it's that important anymore, but because people continue to raise it. It was raised at the time of *McMahon*. Basically the argument is that firms have all of the bargaining power when they create these agreements and require customers to sign them in order to do business, and therefore, they are unenforceable contracts of adhesion.

This issue was addressed in the *McMahon* case. It has been addressed in a lot of court cases before and after. The bottom line is that even if these agreements are contracts of adhesion, they are still enforceable.

A lot of firms will require customers to sign these agreements. However, there is a clearly articulated national policy favoring arbitration in the United States as a result of the Federal Arbitration Act ("FAA").[30] The courts have recognized this strong national policy favoring arbitration, and because there is such a strong policy favoring arbitration, the arbitration agreements are enforceable contracts of adhesion. They are not against public policy.

29. A contract of adhesion is a "[s]tandardized contract form offered to consumers of goods and services on essentially 'take it or leave it' basis without affording consumer realistic opportunity to bargain and under such conditions that consumer cannot obtain desired product or services except by acquiescing in form contract." Black's Law Dictionary 40 (6th ed. 1990). For a full discussion of contracts of adhesion, see John D. Calamari & Joseph M. Perillo, The Law of Contracts, §§ 9-44 to 9-46 (3d ed. 1987).

30. 9 U.S.C. §§ 1-14 (1988). The Federal Arbitration Act was enacted in 1925 by Congress to "place arbitration agreements on the same footing as other private contracts and reduce costly litigation." William A. Gregory & William J. Schneider, *Securities Arbitration: A Need For Continued Reform*, 17 Nova L. Rev. 1223, 1227 (1993) (citing H.R. No. 96, 68th Cong., 1st Sess. 1, 2 (1924)). The FAA also provides for the confirmation, vacation, or modification of awards made in arbitration. 9 U.S.C. §§ 9-11.

Again, that's an issue that has always come up when people discuss pre-dispute arbitration agreements. I don't think it is as big an issue today as it used to be. It is also important to recognize that an investor can always go to a firm that doesn't require an arbitration agreement.

Another issue is that of notice, and this again became a hot issue during the *McMahon* days. Do customers really know what they are signing when they sign these agreements, and do they receive proper notice of what they really agree to when they agree to arbitrate? Do they receive notice that the arbitration process is different than the court process?

There was quite an extensive, public debate after *McMahon* about the whole issue of losing rights in arbitration. It was framed as an issue of rights, and this culminated in New York Stock Exchange Rule 636(a),[31] which is what the industry will say is a very one-sided notice provision that they are now required to put in the arbitration agreement. Basically it states that if you agree to arbitrate, you're waiving your rights to a jury, you're waiving your rights to go to court, to certain appellate rights, and to receive an opinion with factual findings and a statement of the law.

The reason firms feel this is one-sided is because there is nothing in the notice to tell you the benefits you're gaining by arbitration. Nonetheless, there has been an expansion of what has gone into the pre-dispute clause, which started out as a simple concept, and now we've added a whole provision about what rights you supposedly waive.

We must also note, within that particular provision of the pre-dispute agreement, that there will be a minority of people from the securities industry on the panel. This particular rule also required that you highlight in boldface language in your pre-dispute arbitration agreement—just before the place where the customer signs—that you're signing an arbitration agreement and that you recognize that you're signing an arbitration agreement.[32]

So, already the pre-dispute arbitration clause has gone from a very simple two-line notice that everything goes to arbitration, to a number

31. New York Stock Exchange Rule 636(a) requires that any pre-dispute arbitration clause incorporate highlighted disclosure language notifying the customer that (1) arbitration is final and binding, (2) the parties are waiving their right to seek remedies in court, (3) pre-arbitration discovery is generally more limited than and different from court proceedings, (4) the arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited, and (5) the panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry. NYSE Rules, *supra* note 14, Rule 636(a), ¶ 2636; *see also* Uniform Code, *supra* note 14, § 31, at 24 (mirroring the language of NYSE Rule 636(a)).

32. *See* NYSE Rules, *supra* note 14, Rule 636(b), ¶ 2636; *see also* Uniform Code, *supra* note 14, § 31(b), at 24 (requiring separate initialling by the customer, in addition to highlighting the statement).

of clauses. If you look at the standard customer agreement, the arbitration language is the only block of highlighted language in the agreement, and in some agreements it measures about one-third of the agreement. So, there has been quite an evolution in the clause over the years.

The next issue that involved the pre-dispute arbitration clause had to do with class action disputes. This came up after *McMahon* and most particularly after *Rodriguez,* which involved arbitration disputes under the '33 Act, and there was extensive public debate. We don't have to go into a lot of the reasons why the NYSE and the SEC ultimately came up with the rule that they did, but it's now uniform across the board that class actions are not arbitrated at the SROs.[33] Again, that language is language that has to be specifically in the customer agreement—the pre-dispute arbitration clause—that says I agree I will not arbitrate a class action.[34]

As we sit here today, I think it's clear that the pre-dispute arbitration clause has played a role in many of the major issues, or most of them, that have come up over the last ten years; and, I think we'll see as we discuss the substantive issues on the program—eligibility, discovery, punitive damages—it's still the case today.

I would say that the two biggest issues on the agenda today are punitive damages and eligibility. I don't plan on getting into the merits of them, because I have only a couple of more minutes to speak. There will be plenty of conversation with respect to these issues today. I would just like to frame them as they relate to the pre-dispute arbitration clause.

Obviously, punitive damages is one of the most emotional issues that we all faced with respect to arbitration over the past ten years. I've been a member of the NASD National Arbitration Committee and the Securities Industry Association Punitive Damage Subcommittee over the past few years. I've seen an incredible amount of debate over this topic. A lot of good points have been raised on both sides. I can safely say there is no consensus. If you put two people in the room, you can't get a consensus on what is the best way to handle this particular issue.

One thing that's clear, however, is that many member firms are located in New York, and the New York Stock Exchange is located in New York. The law of the State of New York, as articulated by the highest court in the state in *Garrity v. Lyle Stuart, Inc.*,[35] says it's

33. *See* NYSE Rules, *supra* note 14, Rule 600(d), ¶ 2600; Uniform Code, *supra* note 14, § 1(d)(i), at 6.
34. *See* NYSE Rules, *supra* note 14, Rule 636(e), ¶ 2636; Uniform Code, *supra* note 14, § 31(e), at 24.
35. 353 N.E.2d 793 (N.Y. 1976).

against public policy for arbitrators to award punitive damages in New York State.[36] That's the law in New York State.

Apart from the many policy reasons why I personally feel that punitive damages are inappropriate in arbitration, I just want to make the point that it is the law in the state that we're sitting in right now. New York Stock Exchange Rule 636(d), which states that pre-dispute agreements can't limit the ability of arbitrators to make an award,[37] has to be read in the context of what the law is in New York State.

As Professor Katsoris and Chairman Donaldson also pointed out, *Mastrobuono v. Shearson Lehman Hutton, Inc.*[38] is currently before the United States Supreme Court, so we will be receiving some direction from the highest court in the land on this particular issue. The lower courts have gone in both directions on this topic.

The eligibility rule is another matter that has been of major concern both to investors and to brokerage firms over the past three or four years, especially in the area of limited partnership litigation. There will be a lot of debate over this topic over the next couple of hours.

There is a rule at the SROs that claims are not eligible for submission to arbitration if the occurrence or event took place more than six years ago.[39] Many firms take the position that if the occurrence took place over six years ago, it's simply not eligible for arbitration. It should not even be given to the arbitrators. Investors and firms have generated much litigation about whether the appropriate place to resolve this is in arbitration or in court. As you might imagine the courts have, again, gone both ways on this issue.[40]

As we debate these issues over the coming hours, the important point is to recognize that all of the issues that have come up, like the

36. *Id.* at 795.

37. *See* NYSE Rules, *supra* note 14, Rule 636(d), ¶ 2636; *see also* Uniform Code, *supra* note 14, § 31(d), at 24 ("No agreement shall include any condition that . . . limits the ability of the arbitrators to make any award.").

38. On March 6, 1995 the United States Supreme Court, in an 8-1 decision, reversed the Court of Appeals and reinstated the arbitration panel's punitive damage award. Mastrobuono v. Shearson Lehman Hutton, Inc., No. 94-18, 1995 U.S. LEXIS 1820, at *21 (U.S. March 6, 1995), *rev'g* 20 F.3d 713 (7th Cir. 1994).

39. *See* NYSE Rules, *supra* note 14, Rule 603, ¶ 2603; Uniform Code, *supra* note 14, § 4(a), at 9.

40. *Compare* Chemical Futures & Options, Inc. v. Resolution Trust Corp., 832 F. Supp. 1188, 1194 (N.D. Ill. 1993) (holding that because the arbitration agreement, according to its terms, is governed by New York law, courts, not arbitrators, decide statute of limitations issues) *with* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shaddock, 822 F. Supp. 125, 136 (S.D.N.Y. 1993) (holding that the arbitrators should decide any limitations issues despite the existence of a New York choice-of-law provision). The New York Court of Appeals recently held that where the parties have mutually agreed that New York law shall govern a dispute, the court determines the statute of limitations question. Smith Barney, Harris Upham & Co. v. Luckie, No. 11, 1995 N.Y. LEXIS 233, at *2 (N.Y. Feb. 21, 1995); *see also* Gary Spencer, *State Role in Securities Arbitration Defined*, N.Y. L.J., Feb. 22, 1995, at 1 (discussing the New York Court of Appeals decision in *Luckie*).

ones before us today, are very emotional, with a lot of heated argument on both sides. However, if you look back historically, we've been able to work together to resolve many of them. Sometimes it has taken a combination of the industry members, the courts, SRO forums, and arbitration committees, but ultimately we've been able to work them out. Sometimes the courts decide, other times we resolve issues in symposia such as this. I guess that's one of the many issues that will be debated today. Thank you.

MR. EPPENSTEIN: I would like to thank Chairman Donaldson and the Exchange for asking me to appear today with Ted Krebsbach once again to go over the pre-dispute arbitration agreement.

When Bob Clemente called me and asked if I would like to speak today, I believe I remarked, "What is there to say that hasn't been said before?" I think it's quite appropriate for the industry to lead on this issue since, as Ted said, this is a contract of adhesion, and after all, what power does the customer have in this area?

Looking for some inspiration as to what to say, I reflected a bit upon the securities arbitration arena in the past seven years since the *McMahon* case, and I reviewed a motion that I'm currently opposing. For years I've fought for the customers' right to choose between the court and arbitration. I'm now working on a brief arguing the customers' right to pursue an arbitration here at the New York Stock Exchange in a multimillion dollar case. I am also opposing a motion brought by the broker-dealer claiming that the customer dispute is not arbitrable, despite the fact that my client signed a broadly worded pre-dispute arbitration agreement. Then it struck me: I'm citing the same cases today that Ted Krebsbach cited seven years ago. Things really have changed.

When Ted and I argued the issue on March 3, 1987 before the Supreme Court in *McMahon*, we were addressing whether the pre-dispute agreement was enforceable years after the *Wilko* decision and a few years following some dicta in another decision by the Court in *Dean Witter Reynolds Inc. v. Byrd*.[41] The Supreme Court in *McMahon*, by a five-four margin, agreed with the industry's position.[42]

How the court would rule today given the issues and the current climate, such as the "state-of-the-art pre-dispute clause," I don't know.[43] The securities industry, now that it has a contract of adhe-

41. 470 U.S. 213 (1985).

42. Shearson/American Express Inc. v. McMahon, 482 U.S. 220 (1987).

43. *See generally* Mastrobuono v. Shearson Lehman Hutton, Inc., No. 94-18, 1995 U.S. LEXIS 1820 (U.S. March 6, 1995), *rev'g* 20 F.3d 713 (7th Cir. 1994). The Court states, "Respondents drafted an ambiguous document, and they cannot now claim the benefit of the doubt." *Id.* at *18. The Court, therefore, rejected Shearson's argument that the inclusion of a New York choice-of-law provision expresses an intent to preclude an award of punitive damages. *Id.* at *17.

sion, has apparently turned its attention to how many other rights of the customer it can eradicate in the customer agreement.

Sometimes, to understand where we are with controversial issues, it's necessary to review the road that took us here. I'll remind you of a few highlights. Professor Katsoris and Ted Krebsbach gave their usual wonderful renditions, but I would like to touch on a few other points.

You may recall when Judge Timbers in 1953, then a lawyer for the SEC, argued for the customer in *Wilko v. Swan*.[44] From that point on, the SEC, for thirty years, through a number of securities act releases, was consistent and even said in a Securities Exchange Act release that the pre-dispute arbitration clause was an unfair trade practice.

The SEC also promulgated a rule that Ted Krebsbach mentioned before, 15c2-2,[45] in 1983, which imposed requirements on the industry that if they were going to use a pre-dispute clause, the customer had to be informed that he still had the right to litigate federal securities fraud claims in court. The SEC's position on the arbitration clause then changed dramatically when it wrote an amicus brief supporting Shearson's position in *McMahon*. Justice O'Connor wrote the majority opinion in *McMahon* finding that the pre-dispute arbitration agreement was a bargained for agreement[46] and would be enforceable.

Only a few months after the *McMahon* decision was rendered, I was asked to appear at a securities conference where the hot topic was how broker-dealers can best structure their customer agreements so that they will be able to protect their bottom line. This is not so much different from what has been going on recently. Given the enthusiasm among the attendees present at that conference, there was little doubt in my mind that we were going to see some creative revisions to the arbitration clauses.

The arbitration clause that Shearson gave the McMahon's to sign was simple, as Ted Krebsbach mentioned. It said something like this: "Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement, or the breach thereof, shall be settled by arbitration in accordance with the rules then in effect at the NASD, the New York Stock Exchange, or the American Stock Exchange."

The arbitration agreement before the court in *McMahon* is about ten years old now. I would like to tell you something about some of the more recent clauses in use today. There was one that *Securities Week* recently made note of.[47] In one paragraph, that agreement per-

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44. 346 U.S. 427 (1953).

45. 17 C.F.R. § 240.15c2-2 (1983), *repealed by* Exchange Act Release No. 25034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987).

46. *McMahon*, 482 U.S. at 242.

47. *Attorneys Ask NYSE and NASD To Explore Smith Barney's Customer Agreement*, Sec. Wk., Nov. 7, 1994, at 1.

mits the broker-dealer to go to court to challenge any claim brought beyond the statute of limitations period or beyond other time bar periods like the six-year eligibility rule. The broker-dealer charitably grants the right to the customer to do the same thing. Of course, that would never happen.

Another provision in that agreement embraces New York law regarding damages recoverable in arbitration without giving effect to principles of conflicts of law. But in an attempt to limit the rights of the customers residing outside of New York, the broker-dealer chooses the law of those foreign states, trying to find a state where common law claims of fraud and breach of fiduciary duty have less than a six-year life span. All of this is contained in one pre-dispute arbitration clause. Another firm gives the customer the right to go to court but it must be in New York and only before a judge since a jury trial is waived.

There are many troubling aspects concerning the manner in which the pre-dispute clauses are forced on the public. Many firms have their so-called financial consultants obtain the customer's signature on multi-page documents. Here's one example. It's an eight-page agreement entitled "Commodity New Account Booklet" where about ten signature lines appear throughout the document. The arbitration agreement is on page five, buried somewhere. In another customer agreement, the arbitration clause appears on the back at the bottom, at paragraph twenty-eight.

But it really doesn't matter where the clause appears. It really doesn't matter what disclosure there is to the customer because we all know with securities accounts the customer either signs the agreement and opens up the account or he can't open up that account. And he can't go next door to Merrill Lynch or to Lehman Brothers or to Paine Webber because every big firm has the same policy. You either sign it, or they don't want your business.

I had one client who had approximately a $15 million portfolio, and he was unhappy with his broker—that's why he came to me. He wanted to move his account to another firm during the time that we arbitrated his claim. He went to several firms, found one that he was satisfied with, and then said to me—when given the new account form—should I sign this? I said, well, you're in arbitration today, you wanted to go to court but you couldn't because there is a pre-dispute arbitration clause. If you want to go and arbitrate if you have another dispute then go ahead and sign, but maybe the firm will permit you the opportunity to go to the American Arbitration Association. So, ask them if you could just slip in that little clause.

He called me back a few days later and he said no. He said they wouldn't permit him to do that. I said, well, what will they let you do. He said, "Nothing. They told me they don't want my business unless I sign up." That's unfortunately indicative of where we are today.

Now, in normal contract negotiations I would recommend to my client, or to a prospective client, to retain a lawyer to explain the provisions of this agreement to him. However, since these agreements aren't subject to negotiation at all, it will make little difference to the customer whether he understands them or not.

Of course, with a commodity account, there is a separate signature line as required by a Commodity Futures Trading Commission rule which states that the firm must accept the customer even if the customer doesn't sign on the dotted line where the arbitration clause appears.[48]

Another problem is the way these agreements are given to the customer. I've heard from so many clients of mine that they are told that these documents are "red tape" and they have to be signed. And as you can see, they are all printed, they are not negotiated, and customers just blindly sign without reading them.

Who wants to read an eight-page document, including all sorts of things like risk disclosure and all sorts of margin agreement information at a time when they are opening up an account with a trusted brokerage firm with a great reputation? I mean, clients in this world just don't do that. I have also heard the way financial consultants will just gloss over the document with the client and have them sign it after telling them about all of the millions of dollars that they will be able to make for them in their account.

We're in a situation now where I'm concerned about the clauses that I'm seeing coming out of creative general counsels' offices. Where is this all going to stop? What are the limitations and just how far can the industry go in order to structure a pre-dispute clause where the public just has no bargaining rights at all?

Unless Congress, the courts, the NASD, the New York Stock Exchange, or the SEC steps in, we're headed for more litigation than arbitration in this area, before the merits are even reached.

Discussion

PROF. KATSORIS: Thank you, Ted. At this point we will open the forum for brief comments by anybody who wishes to comment on anything that either of the two panelists said.

MR. LIPNER: When we look at the arbitration laws and we talk about how it is a contract of adhesion, the United States Supreme Court has said that it's okay, because we're not suspicious of arbitration. That's an issue that even Ted Eppenstein could agree with as a concept, and I think he started off by saying he did. But there is a more odious piece of the agreement and that's the New York choice-

48. Voluntary Procedure and Compulsory Payments, 17 C.F.R. § 180.3(b)(1) (1994).

of-law clause, and that comes from someone who practices law only in New York.

The fact of the matter is that over the last year or two this former arbitration lawyer has become a litigator in court. A lot of it stems from the existence of the New York choice-of-law clause. That's not the piece that I want to talk about, the New York choice-of-law clause and the fact that it has engendered all this litigation. Rather, I want to focus on what the choice-of-law clause does to the states, and what it does in the system of federalism, and what it does in a system where each state is a sovereign of sorts.

Many states have blue sky laws.[49] The blue sky laws say that certain practices must be adhered to and that certain remedies exist in the case of a violation of a blue sky law. Florida, for example, requires prospectus delivery, not simply filing with the SEC, before taking a solicitation on a limited partnership.[50] Florida blue sky law provides for attorneys' fees and certain statutory damages in the event of a violation of the blue sky laws.[51]

But day in and day out we have legal proceedings here in New York in an attempt to disenfranchise the legislators and judiciary of these other states. These blue sky provisions contain no waiver provisions. They say the parties to a securities transaction cannot waive their rights under these blue sky laws.

The securities industry could not fashion an agreement with its customers that waived these blue sky laws. Yet, by using the New York choice-of-law provision, these blue sky laws are thrown out the window, and New York law, with its limitations on remedies, with its limitations on rights, comes in the back door. The industry effectively does with the agreement and the New York choice-of-law clause what it could not do in any other way. And that's what is wrong with these agreements.

MR. PELOSO: I think it's time for the industry to step back and reexamine the pre-dispute provisions in their agreements. I think what has happened over the past number of years is that the situation has been turned on its head.

49. Blue Sky Laws are "[a] popular name for state statutes providing for the regulation and supervision of securities offerings and sales, for the protection of citizen-investors from investing in fraudulent companies." Black's Law Dictionary 173 (6th ed. 1990).

50. Fla. Stat. ch. 517.07 (1994) (requiring the furnishing of a prospectus before any security is sold or offered for sale); Stowell v. Ted S. Finkel Inv. Servs., Inc., 489 F. Supp. 1209, 1224 (S.D. Fla. 1980) (holding that limited partnerships are encompassed within the Florida Sale of Securities Law's definition of "security"), *aff'd on other grounds*, 641 F.2d 323 (5th Cir. Unit B 1981).

51. *See, e.g.*, Petrites v. J.C. Bradford & Co., 646 F.2d 1033, 1036 (5th Cir. Unit B June 1981) (affirming an award of attorneys' fees where there was a violation of a Florida Blue Sky Law).

I can remember in the sixties dealing with cases where the industry was trying to arbitrate and the public was trying to avoid it. The industry wanted to do it because it was relatively simple and roughly fair. The claimants didn't want to do it because they wanted all of the panoply of federal and state court. That has been totally reversed, and we seem to be focusing on totally different things.

The reality is, in my opinion, that arbitration was always a good idea for most claims because it was relatively simple, not complex, relatively swift, reasonably inexpensive, and a good way to get a dispute dealt with. It has never been a good idea, and has turned out not to be a good idea, for claims that are complex, where you have non-lawyers having to render opinions on the securities laws and RICO statutes, for example. Most of the arbitrators are not lawyers, much less judges, and they don't have to give opinions. So, you now have a process that the claimants, it seems to me, want to have, while the industry is thinking twice about whether they want to have it.

It seems to me the solution is to step back and consider whether arbitration is a good idea for both sides of the issue, for sophisticated, complex, and huge claims. My own opinion is that it's not. Both sides give up the right to appellate review. They give up the safeguards of evidentiary standards. They give up the discovery rights that they have. It wouldn't matter whether I was representing a claimant or a defendant. If there was a reasonably important case, I think both parties are better off in the courthouse. I think that everybody should sit back and think whether this process is really geared up for the kinds of claims that are now being presented to it or whether the agreements should limit arbitration to claims up to a certain amount.

MR. WEST: I'm always a little reluctant to volunteer to a law professor, but before I came to the states I was a Commissioner with the Commodity Futures Trading Commission and I was interested in what Mr. Eppenstein had to say. What did he say? That indeed there is a very simple and separate agreement to arbitrate in the industry. It's very clear. The boldface is set out in the language of the CFTC.

If I could elaborate a bit, it's also voluntary. The Commodity Exchange Act,[52] when it was passed in 1974, provided that arbitration would be voluntary so that there is also a very clear agreement that customers understand that by signing this agreement they may be waiving their right to go to court, but nevertheless they have forty-five days in which to choose to go to court.[53] That's called a 45-day window, or they can go to a program at the CFTC called reparations.

52. 7 U.S.C. §§ 1-26 (1988 & Supp. IV 1992).

53. Voluntary procedure and compulsory payments, 17 C.F.R § 180.3 (1994). Sections 180.3(b)(3) and (b)(6) provide a 45-day window for election of reparations in lieu of arbitration. 17 C.F.R. § 180.3(b)(3), (b)(6) (1994). A person suffering losses resulting from violations of the CFTC may seek reparation—payment—against the violator. *See id.* § 180.3(b)(3).

I spent much of my ten years at the CFTC defending the reparations program because the industry disliked it, and the industry would like to get rid of the 45-day window. I have never quite understood that, because it's been stated here clearly that the pre-dispute agreement is indeed one of the biggest problems in the current securities arbitration arena and undoubtedly has cost the industry and the public a great deal. It seems to me it might be wise to consider indeed making arbitration voluntary by that sort of thing, a window in which the customer could opt out.

I would add that the National Futures Association has an excellent arbitration program. It has grown in leaps and bounds despite the fact that arbitration is voluntary in that industry, and, as a result, they don't have the constant controversy over pre-dispute agreements.

MR. PAGE: I think this discussion highlights what I see as the major issue confronting arbitration. From the industry's perspective I fully appreciate that you would like to have a statute or agreement implemented that says customers never win no matter what happens. As a claimant's attorney, and I think others share this view, I would like to see that any time investors lose money they are guaranteed to get it all back, plus punitive damages, and the like. Neither of those is realistic or salable.

What disturbs me in what I've seen in the arbitration process is what I think started as a good idea—an alternative method of resolving disputes in a quick and efficient method—is now becoming a legal morass, as everyone sits and tries to do creative drafting, i.e., how can I get a step up?

The way arbitration was sold to both the Supreme Court and the SEC was that essentially you have the same rights in arbitration as you would have in court. We're not going to use arbitration to limit the right to recoup damages. We're not going to use arbitration to limit statutes of limitation.

What has happened is with the creative draftsmanship, not only have there been attempts to do through the back door what can't be done through the front door, but you're getting right back to the same problems that we faced at the courthouse, because that's where we're all going first. Everybody is spending a lot of money, and it's becoming almost a self-defeating prophecy. We're making it more expensive, more burdensome, and we're undercutting the very goals that we have for the arbitration process.

I think that we as practitioners and as interested persons have got to go back to what the focus of the process is. It's not going to be perfect for everyone. There are going to be problems for everyone. That's always the key to a system that is the best system because if one side is always totally happy with it, the other side would always be totally unhappy with it, and I think we've got to keep that in mind.

I really think that there are a lot of advantages. Maybe the decision from the industry's perspective is now to say we don't like it anymore. That's fine. Make it optional, give the investors the right to go to court. I've said that a number of times in a number of forums. No one seems to want that. And I think those of you that have been there see that arbitration does work. But if we keep cutting it away, arbitration will go away and then it's not going to be our option anymore. It's not going to be the investor's option. It will all be back in the courthouse. I really encourage everyone in approaching the problem to give some thought to that, because that's very much what I see as a broad overview of what is happening with the process today.

MS. McGUIRE: I am required to give a disclaimer before I speak publicly. I do not speak for the Securities and Exchange Commission, the Chairman, or any individual commissioners or my colleagues on the staff of the Commission. These are my personal views. They are formed over a long period. I have been working on arbitration since the creation of the Securities Industry Conference on Arbitration.

With respect to this topic, I would like to emphasize the role of the self-regulatory organizations. Everyone, I believe, has said that a predispute arbitration agreement is a contract of adhesion that the Supreme Court has said is enforceable. That means it is an area for the SROs to apply the rules of fair practice or just and equitable principles of trade so that the leverage by the firms inherent in a contract of adhesion, that is, their ability to impose that contract, does not result in a contract that contains terms that are not explained and assures that the contract itself is consistent with the rules of the SROs.

To me, what that means is that it is very important that there be the "negative" disclosure, i.e., disclosure of the risks or of the things given up by the investor. In addition, if indeed the choice-of-law or other clauses do not violate the SRO rules, which the Commission in its amicus brief submitted in *Mastrobuono* says they do, then there probably is a need for additional disclosure of the consequences of this creative drafting.

Accordingly, I think it is very timely that we have this Symposium today, because for about two years we have been living with creative drafting and there is a gap in the SRO rules. That is, the rules are either violated or there is a concept that is not being disclosed to customers that comes out of the choice-of-law clauses. So, there is either a need for improved disclosure or for enforcement.

MR. STONE: I've sat here and heard everybody say that we are all in agreement that this is a contract of adhesion. I'm not sure that is entirely correct, and obviously, as an industry representative, I disagree.

As most of the people here today know, there are numerous types of customer accounts that can be opened at brokerage firms. Customers have the option, at least at our firm and most of the big firms on the Street, to open accounts without a pre-dispute arbitration clause. So, to say that your client has nowhere to go, or to suggest it is a contract of adhesion, when you have an alternative, seems to me to be begging the issue. A client can open the account today, tomorrow, or last week at Dean Witter and do business with us with no problem without any pre-dispute contract for arbitration.

I think, however, when brokerage firms do things special—where we, in our instance, allow clients to borrow money from us—we feel we have the right to have a different type of contract with that client. In fact, if the client opens the account with Dean Witter, there is no pre-dispute contract if he or she simply wants to open a cash account and do business with us. So, I find it necessary, at least, to raise those issues. I disagree with some of the other comments since the courts have generally approved pre-dispute arbitration clauses and I feel that the clients basically do have a fair way of doing business with at least our firm.

PROF. KATSORIS: Mike, while you have the floor, when you said that you don't require an arbitration agreement to open an account, are you basically talking about a cash account?

MR. STONE: Yes. Certain types of accounts where we do special things, for example, where we extend money, we feel we have the right to have a contract which provides us with certain protection.

PROF. KATSORIS: Let me follow-up, Mike. Mr. West raised the issue of a 45-day window. What do you think of that?

MR. STONE: A 45-day window to go to arbitration or reparation?

MR. WEST: Or court.

MR. STONE: Same issue. We don't want it and we don't need it for our cash accounts. They can go to court any day they want. I've just explained to you why I think when we extend money to clients, we ask for certain things from the clients, and this is one of them.

MR. EPPENSTEIN: Just to put Mike's comments in perspective, I recall that the last time the SEC and the General Accounting Office looked at this area, they found over ten million contracts had pre-dispute arbitration clauses and over ninety-five percent of the margin agreements and ninety-five percent of the option agreements had pre-dispute clauses.[54] That was, I think, around 1989 or 1990, before everyone just embraced this area. So, I would just like the panel to bear in mind that we're talking about a major issue in terms of the number of people out there who are susceptible to this practice.

MS. SHOCKMAN: Based on my experience in representing, at this point, hundreds of investors and looking at their pre-dispute arbitration clauses, at least in Arizona, I do not believe customers are being

54. General Accounting Office, GAO/GGD-92-74, Securities Arbitration 28-29 (May 11, 1992) [hereinafter 1992 GAO Report].

told that they have the option of signing an agreement that does not have an arbitration provision in it.

Indeed, all of the little old ladies I represent from Sun City and the retirement communities certainly didn't come in with an interest to have margin accounts, but have always signed agreements that permit margin and that contain pre-dispute arbitration provisions in them. No one has told them they may sign something very simple that doesn't have these provisions in them. So, customers routinely are given agreements that have all of these things in them, and they are not being told that they have the option of not having these provisions in your agreements.

Panelist

MR. COONEY: Would this be a good time for me to talk about the banking industry?

PROF. KATSORIS: Yes. Just so we understand that we don't have a monopoly on confusion regarding pre-dispute arbitration agreements, we've invited John Cooney, Senior Counsel at the Bank of America. Other industries are beginning to follow the securities industry, banking being one, where they want to settle their disputes by alternate means. We've invited Mr. Cooney to briefly tell us some of the problems that the Bank of America has encountered in this regard.

MR. COONEY: Thank you very much, Professor Katsoris. I have a handout that I'll pass around in each direction.[55] These are examples of what we've been referring to today as pre-dispute arbitration clauses of different banks, including a couple of examples of Bank of America's clauses.

Just as an example, Professor Katsoris made reference to the fact that questions of arbitration and alternative dispute resolution ("ADR"), which encompasses not only arbitration but mediation and other forms of dispute resolution alternatives to the court system, are certainly not limited to the securities industry. I'm told that there is an attorney in San Francisco who begins his presentations on this subject by holding up a cereal box that says on the side, "If you buy this product and have a problem you're required to arbitrate that dispute." I thought that would be a very good prop, but I was unable to find such a cereal box before I left home.

In any event, we in the banking industry are also facing questions about ADR, as I said, arbitration being just one form. But I thought I would give you just a bit of a perspective about where we have come from on this issue.

55. Documents contained in Mr. Cooney's handout are on file with the *Fordham Law Review*.

Bank of America has been something of a pioneer with regard to ADR. It all began in the mid 1980s when the lender liability theory of recovery from banks came into vogue. Lender liability was and still is a theory to the effect that the bank bears responsibility for its customers' business judgment and losses. That theory has become less popular as the law has evolved, but in the eighties, we suffered some tens of millions of dollars in jury verdicts. Every single one was reversed on appeal, but it cost a lot of money to get to that point.

That brings me to a point I would like to make, which is that the prime reason for our interest in ADR is not large jury verdicts, although that certainly is a concern, but the cost of the system and the cost of retaining lawyers in large numbers to spend large amounts of time on activities that perhaps can be avoided.

In any event, in 1985 we began putting in our mid-level commercial loan agreements and workout agreements the arbitration clause that appears at the beginning of your handout. It runs some three pages. That's the current version of what we call the standard long form arbitration clause.

Just to go through the handout for a moment, the second item is a one-page arbitration clause that we use for safe deposit box rental agreements. After that you'll find the entire complaint in a lawsuit that I will discuss that challenged our right to specify the use of ADR for disputes involving credit cards and deposit account agreements, and, at the back, Exhibits A and B are the actual announcements of those two programs that were sent with statements to the customers.

Then the last items, just by way of comparison and contrast, are Wells Fargo Bank's Comprehensive Dispute Resolution Program, which was announced about the same time in 1992, Union Bank's plan, and then Bank of California's. You'll notice if you look at them closely that they are very different even though they are all ADR programs.

One of the big differences between our situation and yours is that I understand the criticism leveled against the securities industry arbitration program is its close alliance with the industry. We don't have an industry sponsor who originated a program of ADR in the banking industry. At Bank of America, we use, as you will see, the services of the American Arbitration Association. Wells Fargo uses the services of the Judicial Arbitration and Mediation Service.

I suppose, though, the equivalent of that criticism against your industry is the criticism we receive that the bank, as a repeat user of the services of a certain ADR provider, in our case the AAA, will receive preferential treatment. We feel that criticism is blunted by the fact that the AAA is a non-profit organization and its arbitrators are not employees of the organization, but independent contractors. But we recognize that criticism is there, and it is hard to avoid it entirely.

Since the mid-eighties we have expanded the use of ADR at Bank of America to other fields of our business. We started with commercial loan workout agreements. We've expanded it to vendor contracts, safe deposit box agreements, and some other areas. We have avoided some other areas, for example, letters of credit, where we feel that customers simply will not understand and will be frightened off by something new and different. But we've had very little customer resistance with regard to our arbitration clauses. These arbitration clauses are, for the most part, safe deposit box clauses being an example to the contrary, negotiated agreements.

Finally, in June of 1992, Bank of America announced it was making ADR part of our agreement with deposit account and credit card customers. We immediately were sued in a case that's included in the handout, *Badie v. Bank of America*[56] in the California Superior Court. As I said, attached as exhibits are the actual announcements of the program to customers.

In essence what we said was that the further use of those accounts would constitute an agreement to those provisions. There having been very little interest prior to that, suddenly there was a great deal of interest. After we were sued in *Badie*, we suspended use of those clauses pending the outcome of that case. We received a number of complaints as well, both oral and written. Interestingly, most of the complaints were from lawyers.

In any event, what has happened with the *Badie* case is that it went to a non-jury trial after pending for about a year and a half. The trial judge announced his opinion in favor of the bank on all principal points. He has not yet completed his written decision.[57]

Interestingly, with regard to some of the comments made earlier, in the trial of that case, a prominent point was the argument by the plaintiffs that if Bank of America were allowed to "get away with this," other banks will all follow suit and eventually the customer will not have any choice. I've given you ADR provisions of other prominent banks in California, but certainly those are not all of the banks. There are many financial institutions in California, and there is no sign that all banks are going to adopt ADR.

I would like to add a couple of points on the *Badie* case. As I said, those provisions have not been implemented during the pendency of the lawsuit, so two years later we still do not have examples of how it will work. Second, the bank has adopted a policy that it will not demand ADR when the customer files suit in Small Claims Court. In California the jurisdictional limit in Small Claims Court is five thousand dollars. So, if there is a claim of up to five thousand dollars, if

56. Badie v. Bank of America, No. 944916 (Cal. Super. Ct., San Francisco, filed Aug. 4, 1992).

57. Ruling from the bench in favor of Bank of America was issued in August, 1994. *See Badie*, No. 944916, 1994 WL 660730 (Cal. Super. Ct. Aug. 18, 1994).

the customer chooses to go to Small Claims Court, the bank will not demand arbitration or ADR.

I say ADR because if you look at the clause you'll see it's a combination of arbitration or in certain circumstances, in particular class actions, something called reference. Reference is a creature of California law.[58] A referee is appointed by the court. It is an action that remains in court. The referee hears and decides all issues of fact and law, and there is an appeal, if either side chooses to do so, just as in court. The prime benefit of reference is that it is much faster because it takes the litigants out of standing in a line waiting for a courtroom and a judge.

I'll make some general remarks about what is happening in the banking industry and particularly in California with regard to ADR. People in California are choosing sides in the great debate about ADR. To my dismay, some consumer groups are throwing in with the trial lawyers to oppose what they call "forced ADR," which is contractually required ADR. I have pointed out to the trial lawyers who are concerned about maintenance of the civil trial system that ADR is propping up their trial system. The "three strikes law,"[59] three felonies and life in prison, is going to make matters worse by forcing more trials in criminal cases.

To consumer advocates, I say they should note the advantages of ADR. There has been a lot of talk around this table about what some might view as overreaching on the part of some drafters of ADR clauses. We've gone to some great lengths in devising our clauses to try to be fair and evenhanded about them.

There are many things we could have put in our clauses that we didn't. You won't find any specification of the location of the arbitration hearing or any prohibition of punitive damages in any of our ADR clauses. That fits hand in glove with my comment earlier that we're more concerned about moderating the cost of the system than about the results in individual cases. Note also that our clauses are mutual in the sense that ADR is required only if either side asks for it, and either side can do so.

The question often arises about why not make ADR voluntary. The problem we have with voluntary ADR is that our observation and experience indicates that as soon as the dispute arises, the whole situation changes. Certainly mediation is there for anyone to opt for, and mediation has become a very popular form of ADR, perhaps overshadowing arbitration. But mediation always is available. You can choose to mediate at any time, and that does not impose a result on the litigants. But concerning arbitration or other forms of ADR in

58. Cal. Civ. & Crim. Ct. Rules Code § 244.2 (West 1994).

59. *See* Neil A. Lewis, *President Foresees Safer U.S.*, N.Y. Times, Aug. 27, 1994, at 6.

which the result is imposed, our experience indicates that unless it is agreed on before the dispute arises, there is little likelihood of such agreement afterwards. Those are my comments with regard to our situation and our experience.

PROF. KATSORIS: Thank you, Mr. Cooney.

Discussion

MR. BECKLEY: I want to call Mr. Krebsbach as my expert witness for a couple of questions.

Would you concede, Mr. Krebsbach, that a broker-dealer could agree with any of its customers to arbitrate punitive damages?

MR. KREBSBACH: In New York?

MR. BECKLEY: Anywhere, as a theoretical process.

MR. KREBSBACH: In New York it's prohibited by law.[60]

MR. BECKLEY: Would you concede that the New York Stock Exchange rules trump a broker-dealer to the particular choice of language?

MR. KREBSBACH: I think we perhaps are losing sight of the big picture here. We're talking about issues of contracts of adhesion and everything else. Ultimately, we have a system at the New York Stock Exchange and the SROs in general that is providing a general service to the investing public and the firms. I think we also have a court system that is not doing the job, where both investors and institutions such as banks and brokerage firms feel they are not getting a fair shake.

Arbitration is trying to come up with an alternative, which clearly is a better alternative, I think. If you look at the SRO arbitration system, you see a system where fifty percent of the claims that are filed settle and the clients get something. Of the remaining fifty percent, half get an award in arbitration. Seventy-five percent of the people that are filing are receiving a recovery in arbitration.

So, if you want to talk about particular language and particular agreements, I think the SEC and the New York Stock Exchange clearly can address the specific contracts, but I don't think we should lose sight of the big picture which is that it's an excellent system.

MR. BECKLEY: Let's go back and focus on the little picture. If there is a direct conflict between the broker-dealer choice of legal language and New York Stock Exchange rules, which one prevails?

60. *But see* Mastrobuono v. Shearson Lehman Hutton, Inc., No. 94-18, 1995 U.S. LEXIS 1820, at *11 (U.S. March 6, 1995) ("[I]f contracting parties agree to include claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration.").

MR. KREBSBACH: I think the New York Stock Exchange rules will prevail, but I think you have to look at all of them in conjunction with the law.

MR. BECKLEY: Finally, could the broker-dealer in its customer agreement prohibit arbitration on a current basis?

MR. KREBSBACH: Under the New York Stock Exchange rules you have to arbitrate substantive claims.

MR. BECKLEY: Your answer would be the same for suitability and fraud cases?

MR. KREBSBACH: Providing it's not inconsistent with any other area of the law, right.

PROF. KATSORIS: Is that it on cross-examination?

MR. BECKLEY: Yes. Mr. Krebsbach did very well.

PROF. KATSORIS: Two points before we break. One, Caite McGuire raised a very interesting point that part of the focus should be on greater disclosure of the effects and consequences of pre-dispute arbitration clauses. I think we have to do more of such disclosure.

In that connection, in addition to requiring the highlighting of the arbitration clause in the agreement, SICA's Uniform Code has an additional requirement of separately initialing the highlighted statement that says the agreement contains a pre-dispute arbitration clause.[61] In other words, you not only had to sign the agreement, but you had to separately initial the statement that indicated where in the agreement the arbitration clause was located. Unfortunately, no SRO has yet enacted that separate initialing requirement, even though it has been in the SICA Uniform Code for years.

Ted, I hate to raise the next issue because I think it will take longer. SICA also enacted section 31(d),[62] a clause prohibiting conditions that limit the ability of arbitrators to make any award. How is that consistent with all these restrictive clauses that we see being inserted in these arbitration agreements?

MR. KREBSBACH: Well, I think there also is a provision in the New York Stock Exchange rules that says you can't ask an arbitrator to do something that's inconsistent with the law. Maybe I'm wrong on that. I would like to take a second to look at my notes.

PROF. KATSORIS: Why don't we take our coffee break. You'll look at it and then answer it, and then we'll move on to the next panel.

(A recess was taken.)

MR. KREBSBACH: I may have misspoken at the end of the last session about specific New York Stock Exchange rules. The point I wanted to make was that it's clearly the law in New York State in *Garrity v. Lyle Stuart, Inc.*[63] about punitive damages.

61. Uniform Code, *supra* note 14, § 31(b), at 24.
62. *Id.* § 31(d), at 24; *see also* NYSE Rules, *supra* note 14, Rule 636(d), ¶ 2636.
63. 353 N.E.2d 793 (N.Y. 1976).

PROF. KATSORIS: Basically, I think under the SICA Uniform Code, and therefore the New York Stock Exchange rules, you cannot insert clauses in arbitration agreements that limit the ability of arbitrators to make any award.

MR. KREBSBACH: You have to read the clause with the laws in New York State. Punitive damages in arbitration are against public policy. I don't know how you could read that to require a violation of that law.

MR. PELOSO: It might be worth noting that the SEC in 1989 approved those rules. They specifically recognize that was subject to available—the phrase they used was agreements cannot be used to curtail any rights that the parties may otherwise have had in a judicial forum.

If punitive damages or attorneys' fees would be available under applicable law, then the agreement cannot limit parties' rights to request them nor arbitrators' rights to award them.

MS. McGUIRE: It refers to applicable law on the availability of punitive damages in a judicial forum and deals with the fact that there are states that do not allow the awarding of punitive damages in court, but the SEC does not read the clause as importing *Garrity* into the New York Stock Exchange rules. We make that clear in the *Mastrobuono* brief.

As we see it, the case addresses, in part, state law efforts to disadvantage arbitration as compared with litigation. The Federal Arbitration Act, cited by the Commission and the Securities Industry Association in *McMahon*, and later by the SIA in the *Connolly*[64] matter in the First Circuit, does not allow states to impose limits that are hostile to the idea that arbitrators can resolve disputes. Limitations on what arbitrators can do that are not parallel to what judges can do would be hostile to arbitration as a full alternative dispute resolution system.

The position is that securities industry arbitration should be an alternative dispute resolution system that allows for the resolution of all disputes that would be able to be resolved by the courts.

I believe it is quite clear that the release refers to whether punitive damages are available under applicable law in a judicial forum. If these damages are available in a judicial forum under applicable law, the arbitration agreements may not be used to limit them, either explicitly or through more creative means, such as choice-of-law provisions.

I wrote the release.

PROF. KATSORIS: I think that's the final word on that.

64. Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).